IN THE

Supreme Court of the United States

OCTOBER TERM, 19[illegible].

No. 84.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

v.

PELHAM G. WODEHOUSE,

Petitioner.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

PETITION FOR REHEARING.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Pelham G. Wodehouse, by his attorney, Watson Washburn, respectfully petitions this Court for a rehearing in the above-entitled cause, judgment in which was entered on June 13, 1949, upon the grounds hereinafter set forth.

Grounds Relied Upon.

There Was No Withholding of Tax at Source on Non-Recurring Payments for Serial Rights Prior to 1936.

The Court, we understand, accepts the taxpayer's contention that only income which would have been properly subject to *withholding* prior to 1936 could

be taxed to him at all under the 1936 and subsequent Revenue Acts, but holds that the payments to the taxpayer here in question would have been so subject, if paid before 1936.

The Court appears to base this conclusion on the assumption of long established administrative practice. This assumption we respectfully submit is wholly false. The Government itself made no such claim in this case, as an examination of its brief discloses, and there is no factual foundation for any such claim in any Treasury pronouncement or publication, which are all to the contrary.

The Official Treasury Regulations and Decisions.

So far as the Treasury Regulations and Decisions are concerned, which are the chief if not the sole authoritative aid to statutory interpretation (see *Biddle* v. *Commissioner*, 302 U. S. 573, 582), the Court relies mainly on the following paragraph of Treasury Regulations 86, Article 143-2 (1934), and particularly the last sentence, which it italicizes (p. 13 of its opinion):

> "Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. *But other kinds of income are included, as, for instance, royalties.*"

The italicized sentence is apparently the "decisive statement" in support of the supposed withholding practice, referred to at page 12 of the opinion.

In fact, a careful analysis of the history of this paragraph of the Regulations, and particularly of the italicized sentence, in the years 1935 and 1936, prior to and immediately following the crucial 1936 Revenue Act, leads to exactly the opposite conclusion, as we shall try to show.

Throughout the period prior to the 1936 Act all but a very limited category of *dividends* were exempt from withholding, and dividends were not mentioned in the general paragraph of the Regulations quoted above, which was not substantially changed from 1918 through 1934. However, early in the year 1935, to call attention to this limited category, the Regulations were amended by Treasury Decision 4535, approved March 16, 1935 (XIV-1 C. B., 118), by adding to the last sentence the words "*and dividends*", making the last sentence read (italics supplied hereinafter throughout):

> "But other kinds of income are included, as, for instance, *royalties and dividends.*"

The fact that the Treasury Regulations, thus authoritatively amended by a formal Treasury Decision, conjoined "royalties" with "dividends", when only a small category of dividends were then subject to withholding, is alone as strong evidence as could be required that the italicized sentence could not mean that *all royalties* were then subject to withholding.

But even stronger proof followed in the next year, for when the 1936 Revenue Act made substantially *all dividends* subject to withholding, the new Regulations, issued immediately after the passage of this Act as Treasury Decision 4649, XV-1 C. B. 49 (later

incorporated in Article 143-2 of Treasury Regulations 94) transferred *dividends* to the preceding sentence, but left *royalties* in the last sentence, which thus reverted to the language of previous years. Since 1936, the corresponding section of the Regulations has accordingly read as follows:

> "Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income: interest, *dividends*, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. *But other kinds of income are included, as, for instance, royalties.*"

It is seldom that changes in the Regulations immediately preceding and following an Act of Congress such as the 1936 Revenue Act could more clearly expound the language of the latter, as officially interpreted by the Treasury Department. This interpretation, we respectfully urge, conclusively confirms the definition implicit in the above quoted paragraph, that "only fixed or determinable annual or periodical * * * royalties" are included in income subject to withholding; and that *all* royalties are *not* so included.

If the statement that "*other kinds of income are included*" (as subject to withholding) "*as, for instance, royalties*", is susceptible (taken apart from its context, background and history) of the same meaning as if the word "*all*" were added before "*royalties*", yet when considered in the light of the changes made in this sentence shortly before and immediately after the 1936 Revenue Act, and in view of the binding effect of Treasury Regulations in the interpretation of any ambiguities in tax statutes, it seems impossible to ascribe any such unlimited coverage to the language

used. And if the language used did not include *all royalties*, it certainly did not include the "royalties" here involved.

The only other provision found in the Treasury Regulations on which the Court relies to establish long-continued practice are the following sentences of Article 143-2 of Treasury Regulations 101, which it describes (p. 25) as "liberal language" which has been used in the Regulations "since 1918":

> "The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical."

It is hard to see how the above language, unchanged since 1918, can sustain a consistent administrative practice which, even with respect to sec. 119 (4), was, according to I. T. 2735, *supra*, changed in December, 1933. And in the emphasis on "payment" as a criterion of "periodical income", the sentences surely lend support to an interpretation of "periodical income" which gives weight to the mode of payment. We might note that the paragraph of Regulations 101, from which the above sentences are taken, uses the words "paid" or "payments" no less than nine times, as have similar Regulations from 1918 to date. And since this paragraph has thus become in effect part of the withholding, and now of the taxing statute, as a binding gloss, we respectfully urge that the proper importance placed thereby on *recurring payments* as an element of *periodical income* should not be dismissed as "gratuitous" (pp. 23, 24).

The only portion in the above sentences which seems to broaden the statutory meaning is that which says that income is paid "periodically", if it is paid "from time to time, whether or not at regular intervals." But this seems to lend no support to taxability here, for in the first place the income must be "fixed or determinable", as well as periodical, to be taxable; and secondly, it is clear that no further payment can ever be made to this taxpayer on account of these transactions.

The second sentence above-quoted seems entirely irrelevant to this case. It apparently assumes an existing agreement under which a series of *payments* "are to be made" in the future, which "someone" (presumably one of the contracting parties) may extend or prepay, or which are subject to a condition subsequent. As appears from the last three words, the presumed original agreement must have called for "determinable periodical payments," or, substituting the authoritative definitions of the Treasury Regulations, "payments made from time to time, whether or not at regular intervals, where there is a basis of calculation by which the amount to be paid may be ascertained." Such a transaction is wholly at variance with ours.

The Informal Treasury Rulings.

Apart from the Court's official Treasury pronouncements, assumption of pre-1936 withholding usage appears to be based wholly on a single ruling of the Income Tax Unit in December, 1933.—I. T. 2735, XII-2 C. B. 131.

While this ruling is described in the Court's opinion as a "Treasury Decision" (p. 15), it was in fact

merely an Income Tax Unit ruling of the type aptly described by this Court in *Helvering v. New York Trust Co.*, 292 U. S. 455, 468, as follows:

> "The rulings, I. T. 1379, 1660 and 1889, cited by the Commissioner were made before the passage of the 1924 Act but they 'have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law.' See cautionary notice published in the bulletins containing these rulings. It does not appear that the attention of Congress had been called to any such construction."

This case was cited with approval in *Biddle v. Commissioner*, 302 U. S. 573, 582, where the Court noted "the fact that departmental rulings not promulgated by the Secretary are of little aid in interpreting a tax statute."

Less than a month ago, the Tax Court in disregarding two "I. T." rulings of four and five years standing remarked that such "rulings are not Treasury Regulations and as a consequence do not have the force and effect that Regulations are accorded." *Emerson*, decided May 27, 1948, C. C. H. dec. 16,989.

But more important is the fact that this "I. T." dealt solely with the source of income within the United States (I. R. C. sec. 119(4)), and said not a word about withholding. Nor did its reasonings have any relation to the requirements of the withholding section (to which *taxability* was limited by the 1936 Act).

Since the Court has evidently given such weight to I. T. 2735, *supra*, to prove long-established practice as to withholding, even though it made no reference

thereto, we venture to list below a number of informal rulings which actually did deal with withholding,—a point which we did not stress on argument, because the Government's brief made no point of any pre-1936 practice of *withholding*."

If any publication of the Treasury other than its official Regulations and Decisions were deemed important here it would seem to be the special 60-page Bulletin "B" on "Withholding," first issued in 1920, of which the foreword said:

> "This bulletin does not amend the Regulations but amplifies the Regulations. The procedure outlined has been developed as the result of the Bureau's experience, and contains specific instructions for complying with the Regulations. The aim of the Bureau has been to equitably administer the law and this procedure has contributed toward that end."

It contains the following relevant material (p. 11):

> "*Income Subject to Withholding.*
>
> "In this class there is included income such as is enumerated in the law—interest, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. *They are all embraced, however, in the more general class termed of determinable annual or periodical income*'. This phrase refers, generally, to gross income subject to taxation, which is definitely determined or can be ascertained by computation, *and is paid from time to time*. A salesman who works by the month for a commission on sales *and is paid monthly* receives income of this char-

acter. *On the other hand, earnings of lawyers and doctors are not usually within the purview of this provision of the law (unless paid as a regular retainer).*"

This Bulletin was issued in revised form July 1, 1927, "to aid individuals or organizations in the fulfillment of duties imposed on them by law, in connection with 'Collection of income tax at the source' and 'Information at the source'." Of its 48 pages, 38 dealt with withholding. It repeated the language quoted above, and added the following significant new matter:

"A *nonresident alien may receive income from sources within the United States which is taxable but which may not be subject to withholding.* Relief from withholding does not mean that the income is exempt from tax.

"*Income from Sources Within the United States*

"*Royalties* paid to nonresident foreign corporation for the use in the United States of property belonging to such corporation *are income from sources within the United States.*

* * * *

"*Fixed or Determinable Annual or Periodical Income*

"In addition to being from sources within the United States, the income under this title *must be fixed or determinable annual or periodical income.* Income is fixed when it is to be paid in amounts definitely predetermined. On the other hand, it is determinable whenever there is a basis of calculation by which the amount to be

paid may be ascertained. The income need not be paid annually if it is paid periodically, that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with some one's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.

"*The winnings of horses at a race track and credited by racing associations are not fixed or determinable annual or periodical gains, profits, and income.*

"*A commission paid on account of a single transaction is not fixed or determinable annual or periodical income.*"

In its issue of May, 1931 (p. 3), the Internal Revenue News published an article by H. C. Armstrong, Office of the General Counsel, which discussed the taxability of the usual book publishing contract, under which the author receives a percentage of sales. Mr. Armstrong said (p. 4): "This indicates an intention on the part of the signers of the contract that it is merely an arrangement for publication of the book *on a royalty basis, rather than a sale for a lump sum or at a stipulated price.*" He concluded (p. 5): "When royalties are fixed by contract *and are paid to the non-resident alien author periodically*, they come

within the provisions of the statute which require the deduction of income tax at the source from "fixed or determinable annual or periodical gains, profits and income."

In view of the Court's reliance on I. T. 2735, *supra*, we wish to refer particularly to the italicized statement in Bulletin "B", *supra*, that "The winnings of horses at a race-track" are not subject to withholding. This statement was founded on an informal ruling similar to I. T. 2735, but actually dealing with withholding—S. M. 975, C. B. 1, p. 184 (1919). The ruling was cited with approval in G. C. M. 21,575, C. B. 1939-2, p. 172, so that such winnings are now wholly tax-free to non-resident alien owners, though they are obviously income from United States sources and equally obviously not "in the nature of capital gains from profitable sales of real or personal property", to use this Court's words at page 24 of its opinion. That is evidently not the criterion applied by the Treasury to racing profits.

The reason why the Treasury excludes racetrack winnings from the category of "fixed or determinable annual or periodical" income must be that while bettors and book-makers may expect a winning horse to repeat, still (if the race is honestly run) there is no fixed or predetermined basis of calculating at what interval of time (if ever) the horse will win again. The same reasoning, we submit, covers "royalties" of the sporadic type here involved.

Thus we see that non-resident aliens since 1936 have not been subject to tax on speculative gains made here from real estate, security and commodity sales; on agency commissions not paid on a determinable periodical basis; and on race-track winnings. This list of course does not begin to exhaust the category

of income from United States sources which Congress deliberately withdrew from taxability in 1936, but we submit it is sufficient to show the unlikelihood that Congress intended at that time to discriminate against foreign authors, while favoring speculators of all kinds, commissioners, and racing stables,—the last two at all times and speculators since the war, offering no more serious obstacles to collection of the tax than foreign authors, if that is a relevant consideration.

We respectfully urge that there was no administrative practice whatever prior to 1936 to exempt "royalties" from the universal requirement of *fixed or determinable periodicity* to be subject to withholding; that on the contrary the applicable Treasury Regulations, and particularly the changes made therein in 1935 and 1936, are wholly incompatible with any such practice; and that "royalties" here involved would not have been subject to *withholding* prior to 1936, under the law or practice then prevailing; and consequently cannot be held *taxable* since 1936.

CONCLUSION.

For the reasons stated herein, the petition for a rehearing should be granted.

Respectfully submitted.

WATSON WASHBURN,
Counsel for Petitioner.

Certificate of Counsel.

The undersigned, attorney for petitioner in the above-entitled cause, hereby certifies that the within Petition for Rehearing is presented in good faith and not for delay.

Dated June 24, 1949.

WATSON, WASHBURN,
Counsel for Petitioner.